

# Adoption of International Internal Audit Standards in Uzbekistan: Prospective Analysis

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## Abstract

Adequately stable and profitable performance of a firm requires continuous control and regulation of particular performance indicators, management of potential risk and uncertainties derived from market conditions and regulatory framework in the economy. Weaknesses and threats in performance and financial profile of a firm are often identified through findings of internal audit which serves as an internal financial security and early warning system. Nowadays benchmarking and unification actions in internal audit principles and methods actively have been taken around the world due to expanding asymmetry and competition in the market. This article analyses the current and prospective condition of adoption of internationally recognized internal audit principles, procedures and methods in private sector of Uzbekistan's economy.

Key words: Internal audit standards

**Introduction.** Traditionally, internal auditing function has been designed to help ensure reliable accounting information and to safeguard company assets (Spekle et al., 2005). Growing competition and barriers to market access have made companies be careful enough to keep their shares and to stay sound in the market by responding to risks of failure and hidden shock from systemic economic cycle by means of internal auditing. It facilitates the analysis of financial profile and probabilities of hazards from economic condition and regulatory framework. In consistent with developments in business climate, viewing the internal audit function as the most qualified group of professionals to support firm's stable performance with improved governance as well as facilitate key governance processes by monitoring the control and evaluating the operational effectiveness in financial profile.

In the context of transition economy and dynamic economic growth, businesses face great challenges in access to finance and market environment that they need to develop and grow (Hamdamov, 2015). Difficulties in transition process make firms more vulnerable to external shocks and hidden effects depending on the legislative and regulatory framework for business in the economy. Expansion of private sector and development of public private partnership requires stricter control over financial reporting, fiscal relations and risk management in firms as government acts as a supervisor and regulator in economy. In Uzbekistan internal audit has a growing horizon of development and spread on both mandatory and optional basis. Before national independence all firms were public and control over their performance and reporting was completely conducted under the principle and attitude towards public assets which had not pose a need for internal audit due to absence of market failure, market risk and strategic management. After introduction of market principles and private ownership, firms began analysing the market behaviour, evaluating potential risks, focusing on tax avoidance and profit maximization.

## 2. Literature Review

Internal audit issues have been a hot topic among business rounds and academia since 1970s. Researchers and scientists studied several aspects of internal auditing with wider focus on efficiency, relevance, globalization and organizational features. However, only a few academic studies have studied the internal audit standards and even fewer have dealt with the issue of adaptability and benchmarking of cross-border internal audit procedures. In 1980 Glazer and Jaenike found that audit performance according to internal auditing standards contributes significantly to the effectiveness of auditing. Ridley and D'Silva (1997) found in the UK that complying with professional standards is the most important contributor to added value of internal audit. In 2008 Institute of Internal Audit (IIA) published new internal audit standards and extended the scope of work by including attribute, performance and implementation measures. These standards require auditors to conduct auditing in compliance with accepted criteria for professional practice as internal audit activity evaluates and contributes to the improvement of risk management, control and governance using a systematic and disciplined approach. Aaron and Sayag (2010) concluded that compliance with formal standards, as well as a high level of efficiency in the audit's planning and execution – improves the audit's effectiveness.

### 3. Analysis of Current Internal Audit Practices in Uzbekistan

Over the years, there has been steady improvement in internal audit function from undue management influence in Uzbekistan despite comparatively later adoption of legislative basis. In 2000, Government Act on Audition was adopted and later in 2006 Cabinet of Ministers of the Republic of Uzbekistan approved the Charter of Internal Audit in Enterprises. These legislative acts reflect mandatory internal auditing, its requirements and organizational procedures in enterprises with more than 1 billion UZS authorises capital. Till 2006 internal auditors, depending on their particular organization's needs and preferences, worked in several areas: audits of transaction cycles, compliance audits, investigating fraud and other irregularities, evaluating operational efficiency, analysis, measurement and reporting of operational and organization-wide risks, and other assurance and consulting activities. They performed a combination of financial reviews and audits, operational reviews and audits, management audits, and compliance audits. In performing many of these activities, internal auditors made their approach risk-based and controls-focused. As the internal auditing profession became more firmly established, it responded quickly to new demands from significant regulatory and legislative mandates, as well as high-profile international reporting due inflow of foreign enterprises and investors to Uzbekistan's economy. As a legislative initiative to respond to growing demand, Presidential Decree was declared in 2011 introduced qualification and certification requirements for internal auditors. These qualification and certification requirements enhanced general quality and reliability of internal auditing process and outcomes. However, as a counter-effect, number of auditors involved in internal audit decreased nearly twice due to strictness in quality, experience, knowledge and competence requirements (Table 1). From 2015, quantitative requirements for authorized capital of enterprises for mandatory internal auditing altered from 1 billion UZS to equivalent of 100 000 minimal monthly wage set by the government.

<b>Table 1. Number of internal audit checkups in enterprises with authorized capital more than one billion UZS, 2007-2014</b>								
<b>Regions</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
<b>Republic of Karakalpakstan</b>	22	22	24	22	23	23	24	8
<b>Andijan</b>	29	26	33	28	29	24	20	19
<b>Bukhara</b>	14	14	16	35	37	37	37	4
<b>Jizzakh</b>	5	8	12	13	13	18	23	15
<b>Kashkadarya</b>	37	32	35	33	33	33	33	13
<b>Navoi</b>	16	16	16	17	17	17	17	11
<b>Namangan</b>	11	11	15	25	26	25	25	15
<b>Samarkand</b>	28	29	31	34	36	40	43	12
<b>Surkhandarya</b>	35	38	38	33	33	33	33	9
<b>Syrdarya</b>	16	16	16	14	14	13	13	9
<b>Tashkent Region</b>	22	24	16	31	33	35	37	24
<b>Fergana</b>	31	31	32	30	32	37	43	13
<b>Khorezm</b>	33	20	21	19	19	19	19	6
<b>Tashkent City</b>	49	61	73	85	85	98	107	44
<b>Total</b>	348	348	378	419	430	452	476	202
<b>Source: Author's compilations, 2014</b>								

As outlined in abovementioned legislative acts, internal auditing process structured around the analysis and reporting on seven focus areas:

1. Review of operations to ascertain whether results are consistent with established objectives and goals and whether the operations are being carried out as planned.
2. Reliability and integrity of financial and operating information and the means used to identify, measure, classify, and report such information;
3. Review of systems established to ensure compliance with policies, plans, procedures, laws, and regulations that could have a significant impact on operations and reports, and determining whether the organization is in compliance;
4. Review of means of safeguarding assets and, as appropriate, verifying the existence of such assets.
5. Appraising the economy and efficiency with which resources are employed.

### 4. International Internal Audit Standards and Their Adaptability in Uzbekistan

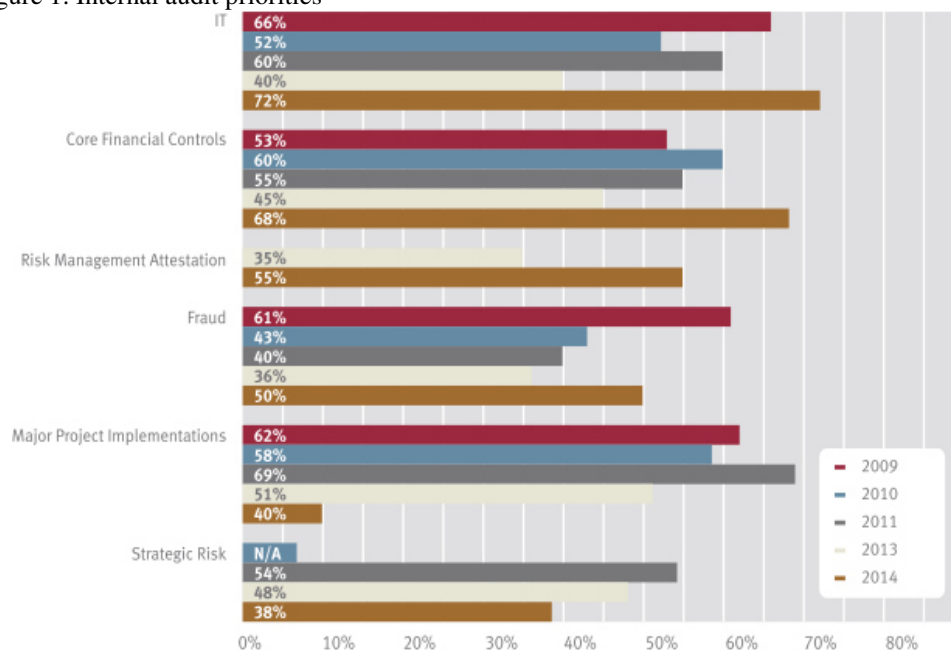
The business environment has experienced rapid and revolutionary change with far reaching consequences for

organizations worldwide. One of the key premises today in any business is that the presence of a strong internal audit function can go a long way in supporting and promoting effective organizational governance (Ramamootri, 2003). Internal audit plays a key role in monitoring a firm's risk profile and identifying areas to improve organizational efficiency and effectiveness through development-led criticism. As Eden and Moriah (1996) studied internal audit has four key components which constructively criticise firm's performance:

- verification of written records
- analysis of policy
- evaluation of the logic and completeness of procedures, internal services and staffing to assure they are efficient and appropriate for the organization's policies
- reporting recommendations for improvements to management

These four components are globally recognized and actively have been used with different levels of orientation in each economy or company. Though generalized systemic approach and principles have been created for simplification of internal audit practices around the world, large differences still exist in scenario of individual economic systems. In advanced economies, business climate is highly sophisticated because of better understanding of risk and business psychology. In developing and some emerging economies internal auditors face shortcomings such as failure to adopt a stronger risk focus, failure to meet Audit Committee needs, poor internal audit reporting, poor internal audit resourcing and inability to drive practical and meaningful improvements. In order to eliminate these problems and mitigate the risk of professional inability risk, transition to international internal audit is accelerated. Adoption of international internal audit standards differs in priorities and orientation of economies and needs of corporate sectors. Recent study of Institute of Internal Audit Australia and Protiviti revealed that business sector's priority and orientation in internal audit has been moving in uncertain path with mixed indicators (Figure 1).

Figure 1. Internal audit priorities



Source: IIA Australia and Protiviti, 2015

Internal auditing is conducted in diverse legal and cultural environments; within organizations that vary in purpose, size, complexity, and structure; and by persons within or outside the organization. While differences may affect the practice of internal auditing in each environment, conformance with International Standards for the Professional Practice of Internal Auditing (Standards) is essential in meeting the responsibilities of internal auditors and the internal audit activity (IIA, 2014). As a part of the International Professional Practices Framework, international internal audit standards are authoritative guidance for the internal auditors proposed by Global Institute of Internal Audit. They are principles-focused, mandatory requirements consisting of statements of basic requirements for the professional practice of internal auditing and for evaluating the effectiveness of performance, and interpretations, which clarify terms or concepts within the statements. International standards highlight the attribute and performance principles of internal audit which are seen as the main areas needing improvement based on international best practices in Uzbekistan.

## 5. Conclusion and Recommendations

Deriving from the current state of internal audit in Uzbekistan and international experience, internal audit system of Uzbekistan should adapt following features of international internal audit standards and best practices:

1. Developing the internal assessment ongoing basis with self-assessment principles and external assessment in each five years by independent expert;
2. Improving the organizational independence and direct interaction of internal auditor with Audit Board.
3. Enabling consulting services for companies which is willing to conduct internal audit as provided in the standard;
4. Introducing the risk-based audit plan and program to national internal audit system covering key risks, emerging risks, horizon risks and regulatory obligations, in line with the firm's risk management and internal control frameworks;
5. Extending the new methods of internal auditing process management in consistent with the standards.

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